

Investing like the rich



By Doug Turek

PORTFOLIO POINT: The same principles that guide the portfolios of the wealthy can also be applied to average investors.

Wealthy individuals and families invest differently to the wider population, in a veiled world of advisers and managers, but that does not mean their investment management practices are out of reach of the less financially endowed.

Australia has a number of single and multi-family offices, probably less than 100 (the exact number is unknown). Family offices are more common in the US, where there are an estimated 2500–3000; but less so in Europe, where the wealthy rely more on private banks.

The Myer Family Office (now 25% owned by the Maple-Brown family), is probably Australia's best known multi-family office in Australia. It provides services to more than 60 members of the original family of Sidney Myer and, since 1999, has offered investment services to the wider public. (By the way, you may need \$30 million of assets for the MFO to be interested in you, in case you are interested in them.)

Other investment offices include the Pratt family's private investment arm Thorney Investments; the Murdoch family's Cruden Investments; a branch of the Smorgon family has been investing since 1927, recently through the private Escor group; and the Packer family has multiple private investment vehicles, including Consolidated Press Holdings. Australians can co-invest with some of these vehicles.

The Rockefeller family office, one of America's oldest, is now managing the wealth of the family's six generation. A key challenge for those families who choose to keep wealth intact across generations is to ensure that the compounding growth in investments outstrips the compounding growth in family members!

Single family offices are uneconomic for portfolios of less than \$100 million, because of the scale needed to justify the cost of employing advisers, investment managers, accountants and others. However, investors with \$10–100 million can quite successfully set up their own "virtual" private family office by carefully using the services of various trusted providers.

Family office investing: what is different?

Most wealthy families take investing seriously. They selectively

adopt approaches used by institutional investment managers and enhance basic practices used by individual investors. So what's so special about family office investing?

The main difference between how individual investors and retail investors manage their money is the level of formality and discipline applied. This can vary from simply a much clearer articulation of investment objectives, approach and decision making to the operation of a multi-adviser investment committee or single or multi-family office.

Key operating disciplines include:

- Ultra-wealthy investors operate using a "living" investment policy. This document guides investment decision making and helps otherwise smart money managers avoid straying from the agreed strategy and making decisions that would put the portfolio at risk. An investment policy is said to "have its greatest benefit during periods of adverse market performance – it acts as a stabilizer".

- Wealthy families have a formal investment monitoring process, which includes comparing hired managers and stockbroker performance to relevant benchmarks and risk taken. The returns and volatility from a directly managed stock portfolio would be, for instance, compared to relevant indices such as the ASX 50, ASX Value index, ASX Small Cap or ASX Growth, depending on the mandate or style of investing. During this same review process, cash flow requirements are forecast and portfolios are rebalanced.

- A lot more effort goes into objective setting, portfolio design and manager or investment selection than retail investors might be familiar with. Managers and brokers would be hired to fulfil a "mandate" and not be allowed to "drift" around and buy as they choose. Their role is to provide returns from specific asset and sub-asset classes that are designed to work together to achieve a target return at minimised risk through diversification. A lot of thought goes into deciding how much funds can be reliably drawn down and whether the fund is following an income or total return policy. (That is striking a balance between income and capital growth).

Wealthy family investing can also differ in several other ways:

- Entity structuring is important. Families hold wealth in different structures for both legacy, asset protection and optimisation reasons. Family trusts, companies, charitable funds and superannuation all play a role. Compared to the allocation of many retail investors in Australia's superannuation-friendly tax system in mid-2008, superannuation might only hold 5–10% of family assets even after maximum contributions have been made.

Investment allocations sometimes need to be tailored to suit the taxation attributes of these structures. For instance, investing in a company might allow one to defer paying out income to higher-taxed individuals but is a poor place to hold appreciating assets owing to lack of capital gains deductions.

■ Taxation management is critical. Substantial wealth often puts beneficiaries into top tax brackets and strategies are needed to minimise the burden of taxation. Investment strategies to minimise tax drag deserve special treatment.

└ Wealthy families are said to invest for three generations and the less sophisticated for Saturday night. This means educating subsequent generations about professional investing and can include involving them in an investment committee early on. Trusts and other entities may outlive individuals reducing the tax issues related with inheritance.

└ Philanthropy is often an important objective for families, and tax-effective prescribed private funds are increasingly popular. There are still only a few hundred of such funds in operation they need special management and a separate investment allocation.

■ Many have made their money from entrepreneurial activities or from being a listed company executive and have wealth concentrated in a single business. Diversification around this and progressive winding down of this concentration risk is often a source of debate

└ People with greater wealth, and those with an entrepreneurial bent, often pursue a significant level of private equity investing. Wealthy families enjoy a private investment “deal flow”, which most don’t. However, extra effort has to be made to properly vet opportunities. Exposure to multiple ventures is needed to find the one in five investments that justify the risk from investing in the four or five that fail or don’t perform any better than the ASX or S&P 500.

Not all wealthy operate this way. Some become the unfortunate customers of elite institutions, paying high fees for comparatively small returns. Others take a hands-on approach to investing, only to find they were better at making money than investing it.

What are the lessons of the family office?

The following might prompt you to explore disciplines that you might introduce into your personal investment management approach.

Do you have an investment policy and do you refer to it when making investment decisions? Australian SMSFs or DIY fund operators are required to have an investment policy statement (IPS). Most treat this as a compliance document that sits unloved in the drawer. That might be the right place

for it if little thought went into its design. Your IPS guides what you invest in and should encourage you to periodically take profits from over heated allocations and reinvest in beaten-up allocations.

How often does your “investment committee” meet? If you have an adviser they should be orchestrating regular review meetings assuming they do more than just look after one of your “mandates”. You might set up your own “virtual private office”, using the services of an investment adviser, accountant and perhaps solicitor. You might meet formally two or four times a year and informally check on your investments monthly. Spend time reviewing your asset allocation and performance, plan your cash flow and consider when and how to rebalance. Many should spend the in between non-working time golfing, fishing or with family rather than tinkering with their portfolio. The revised maxim, “don’t just do something, sit there” might add more value than unrewarded hyperactivity.

How are your investments performing relative to relevant benchmarks and your return objective? Consider both specific benchmarks for the various allocations, for instance, large Australian companies as well as for a blended benchmark for your overall equity/bond portfolio construction. If you or your broker can’t tell what your share portfolio returned (including after costs and tax) and risk taken, then hire someone who can. Volatility is the silent killer of portfolio longevity so don’t forget to look at the variation in your returns.

Are you leaving behind a large inter-generational tax bill or an unwanted asset allocation? Deferring capital gains tax is great but if you or your parent is 80 and in a low tax bracket and planning to pass on a share portfolio to heavily mortgaged, working children, then maybe asset allocation needs revisiting. New stealthy inheritance-like taxes in super also need careful management.

Is your wealth properly structured and where are your distributions going? Sometimes we don’t think enough about who should own what and where distributions from these investments should go. Reinvesting dividends in the name of a geared investor might not always make sense from an asset protection and tax-efficiency perspective, for instance.

Is your wealth too concentrated? You might not be a major shareholder in a company but having more than 10% of your investments in one company should cause you to pause. We Australian investors have reason to be nervous with about 60% of the ASX in financial and resource industries. Having



the quality of one's retirement overly dependent on banks selling mortgages and miners dirt (no offence) might be a risky strategy.

You don't need to be ultra-wealthy to the practices of private office investing, but doing so might hasten your climb up the ladder. ◆

Doug Turek, managing director of the personal advisory firm [Professional Wealth](#), writes and speaks on wealth management.